



CALIFORNIA BOARD OF ACCOUNTANCY

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Initial Statement of Reasons

Related to Regulation Notice dated October 2006

November 2006



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INITIAL STATEMENT OF REASONS

Hearing Date: December 1, 2006.

Subject Matter of Proposed Regulation: Fees.

Amend Section 70 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would amend Section 70 to set the fee for submission of a practice privilege notification with an authorization to sign attest reports at \$100 and the fee for submission of the practice privilege notification without an authorization to sign attest reports at \$50.

Factual Basis/Rationale:

Business and Professions Code Section 5096.15 enacted by AB 1868 (Bermudez, Chapter 458, Statutes of 2006, Attachment 1) declares that it is the intent of the Legislature that the Board adopt regulations providing for a lower fee, or no fee, for out-of-state accountants who do not sign attest reports. Also amendments to Business and Professions Code Section 5134 contained in AB 1868 and SB 503 (Figueroa, Chapter 458, Statutes of 2006, Attachment 2) provide for two fee levels for practice privilege holders.

Current Section 70 provides for only one fee for submission of a practice privilege notification and sets that fee at \$100. Amendments to Section 70 are necessary to comply with the legislative intent that there be a lower fee for submission of the practice privilege notification without an authorization to sign attest reports.

Setting the fees at a lower level for practice privilege holders who do not sign attest reports and at a higher level for practice privilege holders who sign attest reports reflects the greater consumer risk involved in attest services and the possibility that more Board oversight might be required in this area.

It is estimated that establishing the fees at the levels provided for by this proposal will allow the Practice Privilege Program to continue to be self-supporting. Any lower fee would result in Practice Privilege Program costs being subsidized by renewal fees.

Underlying Data:

Technical, theoretical or empirical studies or reports relied upon (if any): None

Business Impact:

This regulation will not have a significant adverse economic impact on businesses.

This proposal provides for a lower fee for the submission of a practice privilege notification without an authorization to sign attest reports. Practice Privilege holders who do not sign attest reports (approximately 64% of all practice privilege holders) provide many critical accounting services such as the preparation of tax returns for businesses. Charging a lower fee for these accounting professionals will encourage them to participate in the Practice Privilege Program. This will help to ensure that California consumers and businesses have a broad range of choices and can receive the services they need from accounting professionals anywhere in the country.

Specific Technologies or Equipment

This regulation does not mandate the use of specific technologies or equipment.

Consideration of Alternatives

No reasonable alternative which was considered or that has otherwise been identified and brought to the attention of the Board would be either more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

The Board considered, in concept, setting the fee at less than \$50 for practice privilege holders who do not sign attest reports. This alternative was rejected because it was estimated that setting the fees as provided for in this proposal would allow the practice privilege program to continue to be self-supporting, while a lower fee would not enable the program to be self-supporting and would require that program costs be subsidized by renewal fees paid by California licensees.

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**INITIAL STATEMENT OF REASONS**

Hearing Date: December 1, 2006.

Subject Matter of Proposed Regulations: Audit Documentation, Continuing Education, Substantial Relationship Criteria.

Amend Section 68.3 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would amend subsection (a) of Section 68.3 to indicate that the retention period for audit documentation required by Business and Professions Code Section 5097 shall be measured from the date of issuance of the report (report release date) rather than the report date. The report date is generally the date of completion of the audit fieldwork. The date of issuance of the report is the date the report is signed and released. It is also called the report release date. Generally, the date of issuance of the report is no more than one month after the report date.

Factual Basis/Rationale:

The start date for the audit documentation retention period specified in current Section 68.3 is different than the start date currently in professional standards. The amendment to Section 68.3 contained in this proposal is necessary to update Section 68.3 to make it consistent with professional standards. These professional standards are Auditing Standard No. 3 issued by the Public Company Accounting Oversight Board (PCAOB) and Statement on Auditing Standards No. 103 issued by the American Institute of Certified Public Accountants Auditing Standards Board (ASB). Generally, the PCAOB standard applies to audits of public companies, and the ASB standard applies to audits of non-public companies.

In 2003, the California Board of Accountancy adopted Section 68.3 along with Sections 68.2, 68.4, and 68.5 to implement newly enacted Business and Professions Code Sections 5097 and 5098 related to audit documentation. The report date was selected as the start time for the audit documentation retention period because it was a readily accessible date.

At the time Section 68.3 was adopted, the PCAOB had not developed its audit documentation standard, and the ASB had not yet updated its standard. Subsequently, in February 2005, the PCAOB adopted its audit documentation standard (Auditing

Standard No. 3). Also, in March 2006, the ASB standard (Statement on Auditing Standards No. 103) was published with the intent that it replace the previous audit documentation standard.

While the ASB standard provides for a five-year document retention period and the PCAOB standard provides for a seven-year document retention period, both standards begin the retention period on the date of issuance of the report (also called the report release date).

The amendment to Section 68.3 contained in this proposal is necessary to update Section 68.3 for consistency with these professional standards and to minimize any confusion that could occur when auditors must comply with two different requirements. (See Attachments A, B, and C for excerpts from the minutes of the meetings of the Board's Committee on Professional Conduct where the revisions to Section 68.3 were discussed.)

Amend Section 68.4 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would make several revisions to Section 68.4 related to audit documentation. Subsection (a) of current Section 68.4 provides a definition of changes in audit documentation. This proposal would add a new subsection (a) to indicate that audit documentation that is not completed prior to the date of issuance of the report shall be completed during the document assembly period. Paragraph (1) of proposed subsection (a) provides for a 60-day document assembly period following the date of issuance of the report during which audit documentation may be assembled. In the event a report is not issued, paragraph (1) indicates the document assembly period would be 60 days from the completion of the fieldwork or the date when the engagement ceased. Paragraph (2) of proposed subsection (a) indicates that if professional standards provide for a shorter document assembly period, licensees shall comply with the applicable professional standard.

This proposal would reletter current subsection (a) as subsection (b) and would significantly revise it. Subsection (b) in this proposal indicates that after the end of the document assembly period, the removal, deletion, substitution or editing of audit documentation is prohibited. Additions to audit documentation must comply with the requirements in subsection (c).

This proposal would reletter current subsection (b) as subsection (c) and would significantly revise it. Subsection (c) in this proposal requires that the record of additions to audit documentation include the reasons for the addition, the identity of the persons preparing and approving the addition, and the date of the addition. This proposal retains the provision in current subsection (b) indicating that the record of the change to audit documentation must contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with the audit engagement, to understand the nature, timing, reasons for, and extent of the change.

This proposal would reletter current subsection (c) as subsection (d), and would delete the first sentence. This proposal would also substitute the word “section” for “subsection” in the last sentence to indicate that nothing in Section 68.4 as proposed to be amended authorizes the deferral of audit procedures required to be performed prior to the date of issuance of the report.

Factual Basis/Rationale:

Current Section 68.4 defines changes in audit documentation. Current Section 68.4 provides for changes to audit documentation and requires that a comprehensive record be made of the change. The single exception to this comprehensive documentation requirement is that additions to audit documentation occurring within 60 days of the date of issuance of the report do not need to be documented.

Current Section 68.4 was adopted by the Board in 2003 to implement newly enacted Business and Professions Code Section 5098 to specify procedures for identifying and dating changes in audit documentation. This proposal updates this regulation for consistency with current professional standards.

As discussed in the Factual Basis/Rationale for the proposed amendments to Section 68.3 above, when current Section 68.4 was adopted by the Board, the PCAOB had not developed its audit documentation standard and the ASB had not yet updated its standard. Subsequently, in February 2005, the PCAOB adopted its audit documentation standard (Auditing Standard No. 3), and in March 2006, the ASB published its updated standard (Statement on Auditing Standards No. 103).

These professional standards (Auditing Standard No. 3 issued by the PCAOB and Statement on Auditing Standards No. 103 issued by the ASB) permit both the addition and deletion of audit documentation during the document assembly period, provided the final record contains all of the necessary documentation. Also, during the document assembly period, a record of additions or deletions is not required. However, under these professional standards, after the document assembly period ends, only additions to audit documentation are permitted, and a record of the addition is required.

The amendments in this proposal are necessary to update Section 68.4 to achieve greater consistency with these professional standards and to avoid the confusion that could occur when auditors must implement two different sets of documentation requirements.

Proposed subsection (a) provides for the completion of audit documentation during the document assembly period, that is the 60-day period following the date of issuance of the report. This provision is necessary for consistency with the ASB standard. Proposed subsection (a) also requires licensees to comply with applicable professional standards specifying a shorter document assembly period. This provision is necessary to accommodate the shorter 45-day document assembly period provided for in the PCAOB standard.

Proposed subsection (a) also provides for a document assembly period in the event the report is not issued. Current Section 68.4 does not address this. The addition of this

language in proposed subsection (a) is necessary to correct this weakness in current Section 68.4 by specifying a start time for the document assembly period in the event the report is not issued.

The revised language proposed for subsection (b) prohibits the removal, deletion, substitution, or editing of audit documentation after the end of the document assembly period. Only additions that comply with revised subsection (c) would be permitted. This revision is necessary to achieve consistency with the PCAOB and ASB standards that do not permit deletions after the end of the document assembly period.

Subsection (c) in this proposal specifies the requirements for making a comprehensive record of additions to audit documentation. Both the PCAOB and the ASB standards require that a record be made of any additions. The requirements specified in this proposal are the same, in substance, as the requirements in current Section 68.4. The revisions enhance the clarity and readability of the provision.

The relettering of current subsection (c) as subsection (d) and the other revisions to that subsection are necessary for clarity. Current Section 68.4 only discusses the document assembly period in one subsection. However, the document assembly period is discussed throughout Section 68.4 as proposed to be amended. The amendment to the last sentence substituting the word “section” for “subsection” is necessary to clarify that nothing in any provision of Section 68.4 authorizes the deferral of audit procedures required to be performed prior to the date of issuance of the report.

(For more detailed information, see Attachments A, B, and C for excerpts from the minutes of the meetings of the Board’s Committee on Professional Conduct where the revisions to Section 68.3 were discussed.)

Amend Section 88 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would amend Section 88 to add a new subsection (c). New subsection (c) provides a description of Group Internet-Based Programs (Webcasts). It indicates that this type of program is qualifying continuing education provided the program is based on materials specifically developed for instructional use and the program meets the requirements stated in subsection (a) of this section and the requirements in Sections 88.1 and 88.2. This proposal would also reletter current subsections (c) and (d) as subsections (d) and (e).

Factual Basis/Rationale:

Current Section 88 describes qualifying continuing education programs, including live presentation and self-study programs. It contains no provision specific to continuing education delivered via a Webcast – also referred to as a Group Internet-Based Program. In a Group Internet-Based Program, a licensee participates from his or her own computer in an interactive course presented by a live instructor at a distant location. This proposal would revise Section 88 to include a provision specific to Group Internet-Based Programs.

It has come to the Board's attention that a broad range of courses are currently available as Group Internet-Based Programs. Many of these programs may meet the requirements currently in the Board's regulations for live presentation continuing education. However, there are differences between Group Internet-Based Programs and other live presentation courses. For example, because the instructor and the participant in a Group Internet-Based Program are not present in the same physical location, monitoring attendance and responding to questions must be handled differently. Because of the differences between Group Internet-Based Programs and other live presentation continuing education, the Board concluded that to provide for quality continuing education to be delivered in a Group-Internet Based (Webcast) format it is necessary to establish continuing education requirements specifically for these programs.

In developing this proposal the Board considered requirements from the National Association of State Boards of Accountancy Statement on Standards for Continuing Professional Education (CPE) Programs and the current procedures used by LearnLive Technologies, a provider of Group Internet-Based Programs. (See Attachments D and E for excerpts from the minutes of the meetings of the Board's Committee on Professional Conduct where this matter was discussed.)

This proposal adds a new subsection (c) to Section 88. This is necessary to define "Group Internet-Based Program" and to specify the requirements those programs must meet to be qualifying continuing education.

The requirements for Group Internet-Based Programs specified in subsection (c) parallel the requirements currently in place for live presentation and/or self-study continuing education programs. Adoption of subsection (c) will make the requirements for Group Internet Based Programs consistent with the requirements for other forms of qualifying continuing education. One requirement is that the program is based on materials developed specifically for instructional use. This parallels the requirements currently in place for self-study courses. It is intended to provide for quality continuing education by ensuring that the programs are developed specifically for an educational purpose. Another requirement is that the program meet the requirements for continuing education programs specified in subsection (a) of Section 88. Subsection (a) of Section 88 contains the basic requirements for continuing education to be acceptable to the Board for purposes of license renewal. Additionally, Group Internet-Based Programs must meet the requirements in Section 88.1 related to continuing education providers and Section 88.2 related to program measurement. This proposal would add provisions specific to Group Internet-Based Programs to both Sections 88.1 and 88.2.

Amend Section 88.1 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would revise Section 88.1 to add a new subsection (b) to Section 88.1 to specify provider requirements for Group Internet-Based Programs (Webcasts). These

requirements include a requirement to monitor attendance; a requirement for a live instructor; a requirement to retain records of attendance, educational goals/objectives, and the course syllabus; and a requirement to issue certificates of completion and retain records of the certificates of completion that were issued. This proposal indicates that providers must comply with these requirements by July 1, 2007.

This proposal also modifies the cross-reference to the subsection of Section 88.2 related to self-study continuing education to reflect the proposed modification and relettering of the provisions of Section 88.2.

Factual Basis/Rationale:

Current Section 88.1 contains no provision specifying provider requirements for Group Internet-Based Programs. As discussed in the Factual Basis/Rationale for Section 88 above, because of the differences between for Group Internet-Based Programs (Webcasts) and other live presentation continuing education, the Board concluded that to provide for quality continuing education to be delivered in a Group-Internet Based format it is necessary to establish continuing education requirements specifically for these programs.

Also, as discussed in the Factual Basis/Rationale for Section 88 above, in developing this proposal the Board considered requirements from the National Association of State Boards of Accountancy Statement on Standards for Continuing Professional Education (CPE) Programs and the current procedures used by LearnLive Technologies, a provider of Group Internet-Based Programs. (See Attachments D and E for excerpts from the minutes of the meetings of the Board's Committee on Professional Conduct where this matter was discussed.)

Proposed subsection (b) of Section 88.1 specifies requirements for providers of Group Internet-Based Programs and indicates that providers of these programs must be in compliance by July 1, 2007. Specifying requirements for providers of Group Internet-Based Programs is necessary to provide for quality continuing education programs to be delivered in a Group-Internet Based (Webcast) format. This start date was selected to indicate when the requirements become operative and to provide lead time to enable providers of Group Internet-Based Programs to come into compliance.

One of the provider requirements is that the provider require and monitor attendance. Attendance is essential for continuing education credit to be granted for both live presentation and Group Internet-Based Programs. Attendance at a Group Internet-Based Program means that the participant is actually present at his or her computer while the course is being presented. Since it is not possible for the instructor of a Group Internet-Based Program to visually observe the participant's presence, another mechanism must be employed to monitor attendance. The requirements in paragraph (1) are necessary to specify this mechanism and indicate the minimum frequency with which this method is to be employed in order to appropriately monitor attendance. In developing this provision, the Board gave consideration to information provided by LearnLive Technologies, a provider of Group Internet-Based Programs. (See Attachments D and E for more information).

A second requirement is that the course have a live instructor who is present at the time the course is being presented, and also a mechanism for participants to ask questions during the course. The Board concluded that the presence of a live instructor who can respond to questions is an essential feature for effective live continuing education.

The remaining three requirements stated in paragraphs (4), (5), and (6) parallel the requirements currently in place for live presentation continuing education. Including these requirements in subsection (b) is necessary to clarify that these same requirements apply to Group Internet-Based Programs. Paragraph (5) indicates that to satisfactorily complete the course the participant must, at a minimum, respond to 80 percent of the questions/surveys described in paragraph (1). This provision is necessary to establish in regulations an attendance requirement for the satisfactory completion of a Group Internet-Based Program. In developing this provision, the Board gave consideration to information provided by LearnLive Technologies, a provider of Group Internet-Based Programs. (See Attachments D and E for more information.)

In subsection (c), relettering the cross-reference to the self-study provision of Section 88.2 is necessary to make this cross-reference consistent with the proposed modifications to Section 88.2

Amend Section 88.2 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would revise Section 88.2 to add a new subsection (b) to establish program measurement requirements for Group-Internet Based Programs (Webcasts). This proposal also would update this section by deleting current subsection (b) specific to continuing education prior to January 23, 2004, and making conforming changes to subsection (c) including updating the cross-reference to Section 88.1(c). This proposal would also make grammatical corrections to subsection (a).

Factual Basis/Rationale:

Current Section 88.2 contains no provision specifying program measurement requirements for Group Internet-Based Programs. As discussed in the Factual Basis/Rationale for Sections 88 and 88.1 above, because of the differences between Group Internet-Based Programs (Webcasts) and other live presentation continuing education, the Board concluded that to provide for quality continuing education to be delivered in a Group-Internet Based (Webcast) format it was necessary to establish continuing education requirements specifically for these programs.

This proposal adds a new subsection (b) to specify program measurement requirements for Group Internet-Based Programs (Webcasts). This is necessary to specify in regulations the program measurement requirements for these programs. Paragraph (1) of Subsection (b) establishes requirements that are essentially the same as the requirements for other live presentation courses. This reflects the Board's conclusion that, for purposes of program measurement, Group Internet-Based Programs and other

live presentation continuing education are highly similar, and consequently the same requirements should apply.

Paragraph (2) of subsection (b) indicates the Group Internet Based Program must comply with the requirements for such programs in Section 88.1 by July 1, 2007. This provision is necessary for consistency with the other provisions in this proposal and also for consistency with the other requirements in Section 88.2.

This proposal also deletes subsection (b) related to self-study prior to January 23, 2004. This change is necessary for enhanced clarity now that the provision is outdated and is no longer applicable to any continuing education courses currently be completed by licensees. Subsection (c) is also amended to delete the reference to the January 23, 2004, date for consistency and to correct the cross-references.

The amendments to subsection (a) are necessary to correct the grammar in that subsection.

Amend Section 89 of Title 16 of the California Code of Regulations.

Specific Purpose:

Section 89 requires a licensee, upon renewal, to provide the Board with specified information regarding the continuing education the licensee has completed for license renewal. One of the items the licensee must disclose is the method of study for the course. This proposal would amend paragraph (4) related to method of study to add a reference to Group Internet-Based Programs (Webcasts). This proposal would also substitute “or” for “of” in the introductory sentence of subsection (d) to correct a typographical error.

Factual Basis/Rationale:

Subsection (a) of current Section 89 on the control and reporting of continuing education requires licensees, upon renewal, to disclose specified information regarding the required continuing education completed by the licensee. The method of study is one of the pieces of information that must be disclosed. This proposal adds a reference to Group Internet-Based Programs as a method of study. This revision is necessary to clarify that a Group Internet-Based Program is one of the methods of study for qualifying continuing education. This revision is also necessary for consistency with the other components of this proposal.

Amend Section 99 of Title 16 of the California Code of Regulations.

Specific Purpose:

This proposal would delete the reference to dishonesty and fraud in subsection (c) of Section 99, and relocate these terms in subsection (a) of Section 99 to indicate that dishonesty or fraud of any kind is substantially related to the qualifications, functions, or duties of a licensee.

This proposal would also add a new subsection (d) indicating that any act or crime posing a risk to the safety or welfare of a client, potential client, co-worker, or other person the licensee encounters in his or her professional capacity is substantially related to the qualifications, functions, or duties of the licensee.

This proposal also would make a minor language change in the preamble by inserting “or her” following “his.” In addition, this proposal would reletter current subsection (d) as subsection (e).

Factual Basis/Rationale:

Business and Professions Code Section 481 requires that each board develop criteria to aid it when considering whether an act or crime is substantially related to the qualifications, functions, or duties of the profession it regulates. The criteria are to be used when considering the denial, suspension, or revocation of a license. Section 99 establishes these criteria for the California Board of Accountancy.

At its meetings in January and May 2006, the Board, through its Enforcement Program Oversight Committee, reviewed the criteria currently in Section 99 and concluded that these criteria are not adequate, and that minor modifications to these criteria would improve the Board’s ability to protect consumers. (See Attachments F and G for excerpts from the minute of those meetings.)

This proposal would make two revisions to Section 99. One revision relates to acts of dishonesty or fraud. Current subsection (c) of Section 99 indicates that acts of dishonesty or fraud must occur in the context of the practice of public accountancy or in the performance of bookkeeping operations before these acts are considered substantially related to the qualifications, functions, or duties of the licensee. This proposal relocates the terms dishonesty and fraud to subsection (a) in order to clarify that dishonesty or fraud of any kind is substantially related to the qualifications, functions or duties of licensees.

Current Section 99 does not contain any provision related to safety in the workplace and the possibility that actions of the licensee could pose a risk to the safety or welfare of others. The addition of subsection (d) is necessary to address this matter. Subsection (d) adds a new criterion indicating that any act or crime that poses a risk to the safety or welfare of clients, potential clients, co-workers, or other persons encountered by the licensee in his or her professional capacity is substantially related to the qualifications, functions, or duties of the licensee.

The other revisions to Section 99 are necessary for consistency of language usage and to correctly reletter the subsections.

THE FOLLOWING RELATE TO ALL SECTIONS OF THIS PROPOSAL

Underlying Data:

Technical, theoretical or empirical studies or reports relied upon (if any): None

Business Impact:

This regulation will not have a significant adverse economic impact on businesses.

The modifications to Sections 68.3 and 68.4, related to audit documentation, will make the Board's audit documentation requirements consistent with professional standards. This may make compliance easier for public accounting firms conducting audits.

The modifications to Sections 88, 88.1, 88.2, and 89 clearly establish Group Internet-Based Programs (Webcasts) as a method of delivery for continuing education programs. This will help to ensure quality programs and also increase the options available to licensees for meeting the Board's continuing education requirements.

The modification to Section 99 related to substantial relationship criteria will have no direct impact on businesses.

Specific Technologies or Equipment

These regulations do not mandate the use of specific technologies or equipment.

Consideration of Alternatives

No reasonable alternative which was considered or that has otherwise been identified and brought to the attention of the Board would be either more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

Set forth below are the alternatives which were considered and the reasons each alternative was rejected.

Alternative Language For Section 68.4

At its meeting of November 17, 2005, the Board considered modifications to Section 68.4 that were developed by the California Society of Certified Public Accountants (see Attachment H).

This language was rejected in favor of the proposal because it only provided for a 45-day document assembly period as in the PCAOB standard and did not provide for the 60-day document assembly period as in the ASB standard. The Board concluded that establishing a shorter document assembly period than the period provided for in professional standards could be confusing and unnecessarily restrictive. This alternative was also rejected in favor of the proposal because it was

concluded that the language in the proposal was more consistent with the language in other Board regulations.

At its meeting of July 20-21, 2006, the Board's Committee on Professional Conduct and the full Board considered alternative word for Section 68.4 (see Attachment I). The alternative language for subsection (a) was rejected in favor of the proposal because of technical weaknesses in the language. Specifically, the reference to audits of publicly traded companies failed to achieve its intended effect of identifying audits under PCAOB oversight. While it is generally true that the PCAOB oversees audits of public companies, the PCAOB also oversees audits of companies that have filed a registration with the Securities and Exchange Commission (SEC) but have not yet begun to trade publicly. Further, there are small companies that trade publicly, but are not required to register with the SEC. Audits of these companies is not under PCAOB oversight.

The alternative language in subsection (b) in Attachment I was rejected in favor of the proposal because it lacked consistency with the language used in the rest of the section. The alternative language in subsection (c) was rejected in favor of the proposal because the language in the proposal had greater clarity and readability.

Alternative Language For Section 88.2

Alternative language for Section 88.2 was considered. This language was essentially identical to the proposal, except that it did not delete subsection (b) related to self-study continuing education prior to January 23, 2004 (see Attachment 5). This alternative was rejected in favor of the proposal because it was concluded that the provision describing self-study continuing education prior to January 23, 2004, was outdated and should be deleted for enhanced clarity.